

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Date:

September 18, 2007

DO: TY:

LEGEND:

Taxpayer =

Parent =

Parent's EIN =

Taxpayer's EIN =

Product=

Predecessor 1 =

Predecessor 2 =

Dear

We received a Form 3115, Application for Change in Accounting Method, filed by Parent (Parent's EIN) on behalf of Taxpayer (Taxpayer's EIN), which is seeking consent to change its method of accounting for the taxable year beginning , , and ending , ("year of change"). In this application, Taxpayer provided the following representations.

Taxpayer operates a natural business unit ("NBU") that manufactures Product. In addition, Taxpayer purchases goods for resale. Taxpayer uses an overall accrual method of accounting. To account for all inventories, Taxpayer uses the dollar-value, last-in, first-out ("LIFO") method and one NBU pool. See § 1.472-8 of the Income Tax Regulations. Taxpayer values all inventories at cost. See § 1.471-3. To price pools, Taxpayer uses the inventory price index computation ("IPIC") method as it existed before the promulgation of Treasury Decision 8976 on January 8, 2002 ("old IPIC method"). Under this old IPIC method, Taxpayer obtains price indexes from Table 6 of the Producer Price Index ("PPI") "Detailed Report" published monthly by the Bureau of

Labor Statistics (“BLS”). Specifically, Taxpayer selects BLS price indexes from the PPI “Detailed Report” for the month of November. When computing a pool’s inventory price index (“IPI”) for the taxable year, Taxpayer uses the 10 percent method with BLS weights, converts BLS price indexes into cost-price indexes, and computes the weighted arithmetic mean of category inflation indexes. In addition, Taxpayer reduces its tentative IPI by 20 percent. Moreover, Taxpayer assigns resale goods to its NBU pool. On _____, _____, Predecessor 1 and Predecessor 2 were merged into Taxpayer in transactions subject to §§ 368(a)(1) and 381(a) of the Internal Revenue Code. Finally, Taxpayer determined that under § 1.381(c)(5)-1(c), the principal method of valuing inventories is the inventory method used by Predecessor 1.

Taxpayer’s application for a CAM has been converted into a request for private letter ruling because of § 1.381(c)(5)-1(d)(1)(i). This regulation provides, in relevant part, that if an acquiring corporation is not permitted to continue the use of the method of taking inventories used by it or the distributor or transferor corporation or corporations on the date of distribution or transfer, and is not permitted, under § 1.381(c)(5)-1(c), to use the principal method of taking inventories, then such acquiring corporation must request the Commissioner to determine the appropriate method of taking inventories. For this purpose, Taxpayer’s principal inventory methods are: (1) the old IPIC method; and (2) the use of an NBU pool that includes both goods manufactured by Taxpayer and goods purchased by Taxpayer for resale. Neither of Taxpayer’s principal inventory methods clearly reflects income.

Section 1.472-8(b)(1) provides, in relevant part, that if a business enterprise is composed of only one natural business unit, one pool shall be used for all of its inventories, including raw materials, goods in process, and finished goods. Where a manufacturer or processor is also engaged in the wholesaling or retailing of goods purchased from others, any pooling of the LIFO inventory of such purchased goods for the wholesaling or retailing operations shall be determined in accordance with the rules of § 1.472-8(c) [concerning pools of wholesalers, retailers, etc.].

Section 1.472-8(e)(3)(iii)(A) provides, in relevant part, that a taxpayer may compute the IPI for each dollar-value pool using either the double-extension method (double-extension IPIC method) or the link-chain method (link-chain IPIC method), without regard to whether the use of a double-extension method is impractical or unsuitable. The use of either the double-extension IPIC method or the link-chain IPIC method is a method of accounting, and the adopted method must be applied consistently to all dollar-value pools within a trade or business accounted for under the IPIC method.

Section 1.472-8(e)(3)(E)(2) provides, in relevant part, that under the link-chain IPIC method, the IPI for a dollar-value pool is the product of the weighted harmonic mean of the category inflation indexes determined under section 1.472-8(e)(3)(iii)(D) for each selected BLS category represented in the taxpayer’s dollar-value pool at the end

of the taxable year multiplied by the IPI for the immediately preceding taxable year. The formula for computing the weighted harmonic mean of the category inflation indexes is: $[\text{Sum of Weights} / \text{Sum of (Weight/Category Inflation Index)}]$. The weights to be used when computing this weighted harmonic mean are the current-year costs (or, in the case of a retailer using the retail method, the retail selling prices) in each selected BLS category represented in the dollar-value pool at the end of the taxable year.

Section 1.472-8(g)(1) provides that any method of pooling authorized by this section and used by the taxpayer in computing his LIFO inventories under the dollar-value method shall be treated as a method of accounting. Any method of pooling which is authorized by this section shall be used for the year of adoption and for all subsequent taxable years unless a change is required by the Commissioner in order to clearly reflect income, or unless permission to change is granted by the Commissioner as provided in paragraph (e) of § 1.446-1. Where the taxpayer changes from one method of pooling to another method of pooling permitted by this section, the ending LIFO inventory for the taxable year preceding the year of change shall be restated under the new method of pooling.

Section 1.472-8(g)(2)(i) provides that a taxpayer who has been using the dollar-value LIFO method and who is permitted or required to change his method of pooling, shall combine or separate the LIFO value of his inventory for the base year and each yearly layer of increment in order to conform to the new pool or pools. Each yearly layer of increment in the new pool or pools must be separately accounted for and a record thereof maintained, and any liquidation occurring in the new pool or pools subsequent to the formation thereof shall be treated in the same manner as if the new pool or pools had existed from the date the taxpayer first adopted the LIFO inventory method. The combination or separation of the LIFO value of his inventory for the base year and each yearly layer of increment shall be made in accordance with the appropriate method set forth in this subparagraph, unless the use of a different method is approved by the Commissioner.

Section 1.472-8(g)(2)(ii) provides that where the taxpayer is permitted or required to separate a pool into more than one pool, the separation shall be made in the following manner: First, each item in the former pool shall be placed in an appropriate new pool. Every item in each new pool is then extended at its base-year unit cost and the extensions are totaled. Each total is the amount of inventory for each new pool expressed in terms of base-year cost. Then a ratio of the total base-year cost of each new pool to the base-year cost of the former pool is computed. The resulting ratio is applied to the amount of inventory for the base year and each yearly layer of increment of the former pool to obtain an allocation to each new pool of the base-year inventory of the former pool and subsequent layers of increment thereof.

Under § 1.472-8(b)(1), a manufacturer is prohibited from including goods purchased for resale in a NBU pool. Thus, Taxpayer must separate its NBU pool into

an NBU pool for goods produced by Taxpayer and a resale pool for goods purchased by Taxpayer for resale. Because Taxpayer wants to continue selecting BLS price indexes from Table 6 of the PPI "Detailed Report" and to cease using the 10 percent method with BLS weights, Taxpayer must change to the IPIC method described in § 1.472-8(e)(3). Specifically, Taxpayer must cease converting BLS price indexes into cost-price indexes and must cease reducing IPIs by 20 percent. Taxpayer may use the link-chain IPIC method, provided Taxpayer uses this method consistently. See § 1.472-8(e)(3)(iii)(A). Taxpayer must use the weighted harmonic mean of category inflation indexes when computing IPIs. See § 1.472-8(e)(3)(iii)(E)(2). Taxpayer may use November as its representative appropriate month for selecting BLS price indexes. See § 1.472-8(e)(3)(iii)(B)(3). Finally, Taxpayer must comply with the uniform capitalization requirements under § 263A.

In effecting the change to the proposed method, Taxpayer will establish the year of change as its new base year. Taxpayer will retain all layers of increment previously determined for its dollar-value pool and will retain the LIFO values of those layers. Instead of using the earliest taxable year for which Taxpayer adopted the LIFO method for any items in the pool, Taxpayer will use the year of change as the base year when determining the LIFO value of that pool for the year of change and subsequent taxable years (that is, the cumulative index at the beginning of the year of change will be 1.00). Taxpayer will restate the base-year cost of all layers of increment in its pool at the beginning of the year of change in terms of new base-year cost.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Jeffery G. Mitchell
Branch Chief, Branch 6
(Income Tax & Accounting)